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MEMORANDUM OF LAW

DATE: January 3, 2018
TO: Councilmember Lorie Zapf
FROM: City Attorney
SUBJECT: Downzoning of Water Utility Property Prior to Sale

INTRODUCTION

City staff anticipates asking the City Council to approve the sale of City-owned real property located on Los Altos Road in Council District 2. The property is an asset of the City's Water Utility Fund. The property is no longer needed to provide water service to residents. The City has received an offer to purchase the property, which will be presented to the City Council for approval.

Your office asks if the City is prohibited from rezoning water utility property before it is sold. The property on Los Altos Road is presently zoned for development as RS 1-4, which requires at least 10,000-square-foot lots on the property. Neighbors of the property prefer that the property be "downzoned" to RS 1-2, which requires at least 20,000-square-foot lots. Our understanding is that downzoning the property in this manner, which will reduce the allowed density of its future development, will probably reduce the fair market value of the property, and may require the City to renegotiate the terms of the sale at a lower price.

QUESTION PRESENTED

Is the City prohibited from downzoning water utility property before it is sold?

SHORT ANSWER

No, but if downzoning reduces the market value of the property, the City Council will need to waive Council Policy 700-10. Council Policy 700-10 provides for rezoning City-owned property prior to sale only if rezoning results in a *higher* sale price. The City also risks having to reimburse the Water Utility Fund for the loss in market value if the property is currently zoned appropriately and is downzoned solely to serve the private interests of neighboring property owners.

ANALYSIS

The Water Utility Fund is held in trust to guarantee sufficient revenue to provide water service through a self-sustaining, financially independent utility. 2006 City Att'y MOL 54 (2006-6; Mar. 16, 2006). The Water Utility Fund may only be used for purposes related to the construction, operation, and maintenance of the City's water system. San Diego Charter § 53; 2010 City Att'y Report 489 (2010-6; Feb. 24, 2010). To help ensure the water utility has sufficient revenue to accomplish its mission, the water utility must receive fair market value for the use or sale of its property, even if the property is being used or purchased by another City department. 2014 City Att'y MOL 143 (2014-14; Nov. 26, 2014); 2005 City Att'y MOL 87 (2005-10; May 13, 2005). Water Utility Funds may not be diverted to pay for services or projects unrelated to providing water service. 2010 City Att'y Report 489 (2010-6; Feb. 24, 2010).

Because of these responsibilities and restrictions on the use of Water Utility Funds, this Office has indicated that the City may not deprive the Water Utility Fund of money it is otherwise entitled to receive. For example, the General Fund was obligated to pay rent for the use of water utility property at Qualcomm Stadium even though the stadium was operating at a loss. 2014 City Att'y MOL 143 (2014-14; Nov. 26, 2014). In another matter, we advised that the General Fund could not keep all of a \$27 million settlement associated with the 2007 wildfires because the damages alleged in the litigation involved water utility property and the Water Utility Fund was paying part of the City's litigation costs. 2013 City Att'y MOL 8 (2013-01; Jan. 14, 2013).

Whether or not the Water Utility Fund is entitled to compensation if the City downzones its property depends on the facts of the particular case. Property owners do not have a vested right in existing or future zoning ordinances. *Morse v. County of San Luis Obispo*, 247 Cal. App. 2d 600, 602-03 (1967). A zoning change that merely reduces the market value of the property does not entitle a property owner to compensation. *Helix Land Co. v. City of San Diego*, 82 Cal. App. 3d 932, 944 (1978). Usually, a zoning change would need to eliminate all or almost all economic value of the property before it amounts to inverse condemnation entitling the property owner to compensation. *Avenida San Juan Partnership v. City of San Clemente*, 201 Cal. App. 4th 1256, 1272 (2011).

However, the City Council's policy is to seek the highest sale price when City property is sold. Council Policy 700-10. Toward that end, it is the City Council's policy to change the zoning prior to sale only if rezoning will result in a higher sale price:

Prior to completion of the sales transaction, City land shall be considered for rezoning in accordance with the General Plan, existing community plans or other City Council direction if a higher sale price will result. Also, all unnecessary easements affecting title to the property shall be removed if this will result in a commensurate increase in value.

Id. The City Council would need to waive this Council Policy if the City desires to downzone any City property - not just water utility property - prior to a sale that will lower the value of the property.

We also caution that in at least one instance, a Court overturned the downzoning of certain parcels because the downzoning was solely for the benefit of neighboring residents. *Arnel Development Co. v. City of Costa Mesa*, 126 Cal. App. 3d 330, 337 (1981) (Initiative circulated by residents to downzone neighboring property to single-family residential solely to prevent construction of apartment buildings was invalid as arbitrary and discriminatory rezoning). Downzoning must bear a reasonable relationship to the public welfare, considering changes in circumstances since the property was last zoned and the purpose of the new zoning restrictions. *See Arcadia Development Co. v. City of Morgan Hill*, 197 Cal. App. 4th 1526, 1537-39 (2011). The City risks having to reimburse the Water Utility Fund if its property is downzoned and sold for less than the Water Utility Fund would have otherwise received, unless the City Council reasonably finds that downzoning the property serves the general public welfare.

With regard to the water utility property on Los Altos Road, we do not know if downzoning the property serves the public welfare. Our understanding is that the current zoning of RS 1-4 is consistent with the surrounding neighborhood, which is zoned as RS 1-2, RS 1-4, and RS 1-7. We defer to City Council as to whether there are reasons to deviate from Council Policy 700-10 and consider downzoning the property even though it may lower the sale price of the property.

CONCLUSION

Downzoning City-owned property prior to sale is contrary to Council Policy 700-10 if downzoning reduces the sale price of the property. The City must also ensure that the Water Utility Fund is not deprived of revenue it is otherwise entitled to receive. If water utility property is downzoned prior to sale solely for the private interests of neighboring property owners, the City risks having to reimburse the Water Utility Fund for any reduction in sale price associated with the downzoning, unless the City Council reasonably finds that downzoning the property serves the general public welfare.

Sincerely,

MARA W. ELLIOTT, City Attorney

By */s/Thomas C. Zeleny*
Thomas C. Zeleny
Chief Deputy City Attorney

TCZ:amc:cw

cc: Cybele Thompson, READ Director

Vic Bienes, PUD Director

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